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SERIE RESEARCH MEMORANDA

Perceptions of the Royal Mail Case in the Netherlands

Kees Camfferman

Research Memorandum 1998-36

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Perceptions of the Royal Mail Case in the Netherlands¹

Kees Camfferman

Vrije Universiteit

Faculty of Economic Sciences, Business Administration

and Econometrics

De Boelelaan 1105

1081 HV Amsterdam

The Netherlands

tel +31 20 444 6076

fax +31 20 444 6005

e-mail ccamfferman@econ.vu.nl

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Abstract

The 1931 Royal Mail case, as a landmark event in the history of British accountancy, did not go unnoticed in the Netherlands. Awareness of the case is reflected by a fairly wide scattering of references in contemporary Dutch documentary sources, notably in the literature of the auditing profession. Because of this, the case provides a convenient opening for studying the comparative development of accounting and auditing in Britain and the Netherlands. This paper documents Dutch references to the Royal Mail case from the 1930s to the early 1950s and it presents an interpretation of the pattern and nature of these references. The materials brought together in this paper show that in interpreting the Royal Mail case, Dutch auditors paid more attention to general issues of auditor responsibility than to the issue of secret reserve accounting with which the case is traditionally associated. The case provided support for those who argued with Limperg that the Dutch profession was ahead of Britain in its views on auditor responsibility.

Perceptions of the Royal Mail Case in the Netherlands

1 Introduction

The importance of the Royal Mail case to British¹ accountancy is well established in the literature. According to Edwards (1989: 127), ‘the criticism aroused by the [Royal Mail case] probably had a greater impact on the quality of published data than all the Companies Acts passed up to that date’. Equally forceful is F.R.M. de Paula’s late-1940s image of the Royal Mail case which ‘fell like an atomic bomb and profoundly disturbed both the industrial and the accountancy worlds’ (de Paula, 1948a: 265). The case drew attention to deficiencies in British financial reporting and auditing, and provided an impetus for renewal and modernisation.

Given this impact, it is not surprising that the Royal Mail case attracted some attention in the neighbouring Netherlands as well, and that it left its traces in the Dutch professional auditing literature. This paper documents Dutch reactions to the Royal Mail case from 1931 to the early 1950s and demonstrates the fairly large extent to which Dutch auditors knew about and took an interest in British affairs. The case invited comparisons between the state of accounting and auditing in the Netherlands and in Great Britain, and it is for that reason that a study of Dutch reactions to the Royal Mail case provides useful insights into the comparative history of accountancy in the two countries.

The Royal Mail case is traditionally associated with the demise of secret reserve accounting as a respectable reporting practice. This might suggest the hypothesis that the perceived significance of the case in the Netherlands would also be phrased primarily in terms of the issue of secret reserves. However, this paper argues that at least initially the case was interpreted mainly in terms of a more general and ongoing domestic discussion on the nature of the responsibility of the auditor. As such, the case could serve as support for the view that at a fundamental level Dutch standards of auditing were higher than those in Britain. Rather later, following the War, did the specific implications of the case for secret reserve accounting become a topic of discussion. In terms of de Paula’s bombing imagery, it can be said that,

¹This paper uses ‘Britain’ and ‘British’ as a matter of convenience and not with the intention of restricting the scope of the paper precisely to Great Britain. Similarly, when references to ‘England’ occur in literal translations from the Dutch literature, it should not, as a rule, be assumed that the Dutch authors wanted to restrict their statements to that part of the United Kingdom.

although Dutch auditors considered themselves well-protected from the initial blast by their high standards of professionalism, this did not shield them from the fall-out which during subsequent years influenced long-term developments in British accountancy.

This paper is organised as follows. Section 2 briefly reviews the facts of the Royal Mail case, and the consequences attributed to it in the English-language literature. Section 3 discusses in general the extent of knowledge of the case in the Netherlands. Sections 4 and 5 contain the core of the paper. They show how references to the Royal Mail case in the Netherlands fitted into the ongoing discussion on professional standards in that country. Section 6 contains some concluding remarks.

2 The Royal Mail case

The facts of the case against the chairman of the board of directors and the auditor of the Royal Mail Steam Packet Company² (*Res v. Lord Kylsant, and Another*) are well documented in the English-language literature.³ In brief, the effect of the Royal Mail's accounting policies during the 1920s was to hide a decline in the company's fortunes. In particular, a redundant provision for wartime taxation was gradually released into income. In this way, losses were transformed into apparent profits. This practice was not evident from the published financial statements, which condensed income into an 'omnibus' item labeled 'Balance for the year, including dividends on shares in allied and other companies, adjustment of taxation reserves, less depreciation of the fleet, etc.' In 1926, despite an undisclosed trading loss of £ 507,104, the profit and loss account showed a profit of £ 478,563, mainly because of an 'adjustment' of taxation reserves of about £ 750,000 (Green and Moss, 1982: 72). As the Royal Mail Group's affairs deteriorated, the Treasury became involved in the task of restructuring its finances in 1929-1930. Information provided to preference shareholders in February 1931 in order to gain their support for extending a moratorium provided the feeding ground for rumours that there might be something wrong with the Royal Mail Company's published accounts. Members of the Parliamentary opposition pressed the Government into deciding on a prosecution, and in July 1931 both the chairman of the board of directors, Lord

²In the remainder of this paper, this company and its subsidiaries are referred to as 'the Royal Mail Company'. This was the combination of companies to which the trial ('the Royal Mail case') was confined. The Royal Mail Company was part, however, of a far wider network of companies which, following Green and Moss (1982), is referred to as the Royal Mail Group.

³see Arnold (1991); Bircher (1991); Edwards (1976, 1989); Green and Moss (1982); Jones (1995).

Kylsant, and its auditor, Harold Morland, were tried on charges of publishing false information. In the end, both men were acquitted from charges relating to the 1926 and 1927 annual reports, but the director was found guilty with regard to unaudited information published in a 1928 prospectus. The acquittal was largely based on the testimony of expert witnesses from the auditing profession.⁴ Chief among these was a former president of the English Institute (ICAEW), Lord Plender, who asserted that the succinct reference to 'adjustment of taxation reserves' to describe the nature of the profit balance was in accordance with best current practice.

As the Royal Mail case was 'one of the Old Bailey's most publicised cases in the inter-war period' (Green and Moss, 1982: 141), it is not surprising that it is generally credited with a great impact on British auditing and financial reporting. Although, because of the acquittals with respect to the financial statements, there were no direct legal implications, the case did bring about a process of reflection and debate on the state of British accountancy. Within the auditing profession, the existence of considerable differences of opinion hindered the emergence of an unambiguous reaction: 'Given that many leading professional accountants shared the view of the expert witnesses in the Royal Mail case that there was nothing inherently wrong with the use of secret reserves, the professional response to the case could only be a muddled and ineffective one' (Napier, 1995: 273). Nevertheless, two distinct consequences began to emerge towards the end of the 1930s.

The first consequence, at least the one which 'has received the bulk of the accounting historians' attention' (Edwards, 1989: 232), was a change in attitude towards secret reserve accounting. Even though the formation of secret reserves remained acceptable for a while, their undisclosed release into income ceased to be part of acceptable practice (e.g. Rowland, 1939: 178). The 1945 report of the Committee on Company Law Amendment (chaired by Mr. Justice Cohen), and the wording of the subsequent Companies Act 1947 (in particular Schedule Eight, 27(2)) strongly suggested that the existence of secret reserves, rather than merely their undisclosed release into income, was sufficient to jeopardise the 'true and fair view' to be given by the financial statements (cf. Jones, 1995: 157).

A second important consequence of the Royal Mail case was a change in the perception of the auditor's responsibility. Prior to the case, there was a tendency to

⁴Ashton (1986) attributes the outcome of the trial in part to a weak handling of the case by the Attorney-General, in particular regarding the use made of the witnesses: 'The AG appears to have had no clear strategy in relation to the points that should have been brought out in Lord Plender's evidence. Indeed, an uninformed observer might have thought that he **was** a defense, rather than a prosecution witness.' (p. 9)

interpret the auditor's responsibility in a limited way by a strict adherence to what was specified in the law and in legal precedent. During the 1930s, however, perceived responsibilities expanded because of the increasing recognition of the moral and ethical responsibilities of the auditor (Edwards, 1989; Napier and Noke, 1992).

It may be true, as Bircher (1991) has argued, that the Royal Mail case was only one element of a growing dissatisfaction with the current state of things that eventually brought about these and other changes in British accountancy. Moreover, the case may have been influential for the wrong reasons. Arnold (1991: 203) has claimed that the trial proceedings 'exaggerated and distorted the contributions of secret reserve accounting to the smoothing of RM's profits over the period 1915-27'. Yet there seems to be no doubt that, in the minds of many contemporaries, the case was a conspicuous cause of change. It is because of this perceived significance as a cause *célèbre* that an investigation is justified of the reactions it elicited in the Netherlands.

3 Awareness of the Royal Mail case in the Netherlands

One can safely assume that the Royal Mail Group was well known in the Netherlands before its troubles began. Many companies of the far-flung Group acted as competitors, partners, clients or suppliers of the Dutch shipping industry.⁵ The financial problems of the Royal Mail Company and the subsequent trial attracted considerable attention in the newspapers. For the purposes of this paper, four business-oriented daily newspapers were searched and it was found that all reported frequently on the restructuring of the company and on the trial during the period of May to July 1931. In a number of instances, the events were apparently considered to be of sufficient importance to be reported on the front page.⁶ While much

⁵For example, Green and Moss (1982: 56) describe the competition with the Holland-Zuid-Afrika Lijn during the 1920s. The Holland-Amerika Lijn, a major Dutch liner shipping company, operated a joint service to the Pacific with the Royal Mail Steam Company. It also had a long-standing relation with the Harland & Wolff shipyard (a key part of the Royal Mail Group) from which it ordered a number of hulls, including that of its flagship Statendam (ZZZ) (Wentholt, 1973). Incidentally, Green and Moss (1982: 59) appear to confuse the Dutch company with the Hamburg-Amerika Line in this regard.

⁶See *Algemeen Handelsblad*, 14 May, p. 1 and 3; 16 May, p. 2; 2 June, p. 1; 3 June, p. 1, 2, 8; 9 June, p. 3, 8; 11 June, p. 3, 6; 15 June, p. 6; 23 June p. 3 and 8; 30 June, p. 4; 30 July, p. 4 (all references except 2 and 15 June are to the morning edition). Coverage in *Nieuwe Rotterdamse Courant* was mainly based on the same sources as used in *Algemeen Handelsblad*. See also *De Telegraaf*, 15 May (evening) p. 17; 3 June (evening) p. 14; 23 June (morning) p. 3; 13 July (morning) p. 1; 30 July (evening), p. 13; and *De Maasbode*, 9, 11, 16 June and 21 July (morning editions).

of the coverage was relatively short and of a factual nature, there were also some background articles and commentaries.

Following coverage in the press, the case also made its way, at a slower pace, into the Dutch professional accountancy literature from the fall of 1931 onwards. In the distribution of references to the case over time, a simple pattern is unambiguously present, as these references occur in two distinct phases. First, during the period from 1931 to 1935, a total of 14 publications were found in which one or more references to the Royal Mail case by Dutch authors (or quoted speakers) occurred.⁷ From 1936 to 1945, only one reference to the Royal Mail case was found in the Dutch literature, in an article by a British author (Rowland, 1939). But, after this period of silence, 10 more references were found, dating from the period 1946–1952.⁸ References to the Royal Mail case after the early 1950s are scarce.⁹ What is probably the last reference appeared in a 1970 encyclopaedia of business administration and accountancy, where the case was characterised as ‘being of purely historical significance’ (de Jong, 1970).

From the absolute number of references it can immediately be seen that the Royal Mail case never dominated the Dutch auditing literature of the 1930s and 1940s. But, even in the absence of comparable statistics, it seems fair to state that the case drew rather more, and certainly longer-lasting attention in the Dutch literature than other affairs of the period such as the Kreuger & Toll affair.

It can therefore be inferred that, from 1931 onwards, there was substantial written information about the case available to Dutch auditors. Those who followed the literature could gain a reasonable understanding of the significance of the case for British accountancy. In addition to these sources, the importance of the Royal Mail case would have been brought to attention during the 1933 International Congress on Accounting in London¹⁰, at which a Dutch delegation of considerable size and quality attended.¹¹ The participants could learn directly about the case in the

⁷Hageman (1932a,b, 1935); de Kat (1932); Keuzenkamp (1932); Polak (1933); van Rietschoten (1932); Roosegaarde Bisschop (1932); Spangenberg (1934); Sternheim (1931) and van Dien, quoted in Morgan (1933). Sternheim (1931) and Hageman (1932a,b) were reproduced in their entirety in the November 1931, May 1932 and June 1932 issues of the journal *De Naamlooze Vennootschap*.

⁸Dijker (1948a); Hageman (1947); Hinnen (1948a,b); Hogeweg (1948); NIVA (1946); Porrey (1950); Spinosa Cattela (1948); Stokvis (1950); Tempelaar (1952a), with Spinosa Cattela (1948) reprinted in 1952.

⁹Foppe (1955); de Jong (1970)

¹⁰In 1936, F.R.M. de Paula wrote: ‘In my opinion, the proceedings of that [1933] congress represent a contribution of the first importance in the world of accountancy. They reveal clearly that the profession is moulding definite principles in regard to the serious problems involved in the **Royal Mail Steam Packet** Company case’ (de Paula, 1948b: ix)

¹¹With 23 participants each, the Netherlands and Germany provided the largest foreign delegations after the United States (with 32). Delegates included partners of the major firms and a number of past and present NIVA presidents.

discussion from the paper presented by Henry Morgan (who had been an expert witness for the defence at the trial) (Morgan, 1933), and from the subsequent debate in which two Dutch delegates participated. Those who stayed at home could do so through a summary of the proceedings published in one of the main accountancy journals (Spangenberg, 1934).

There are also indications that Dutch auditors did indeed avail themselves of the above opportunities. Knowledge of the Royal Mail case played a role when auditors gathered for discussion. In the summer of 1932, the subject was sufficiently well known to influence the choice of topic for the annual study meeting of the Dutch Institute of Auditors (NIVA) (Keuzenkamp, 1932). However, the speaker at the meeting thought it useful to outline the circumstances of the case ‘for those who do not know about this trial’ (Keuzenkamp, 1932: 30). During next year’s meeting in September 1933, it was apparently possible to make a passing reference to the case without giving any details, as if everyone present would be able to understand the implications of the case (Polak, 1933: 28). Although no such references occur in records of meetings during the remainder of the 1930s, the knowledge did not disappear. In 1946 or 1950 it was still possible to make a point during a NIVA membership meeting by making a casual reference to the Royal Mail case (NIVA, 1946; Stokvis, 1950).

4 Initial reactions 1931-1935

This section considers reactions to the Royal Mail case during the early 1930s. It is argued that during this period the case had at best a marginal influence on attitudes towards secret reserve accounting. Instead, it is shown that interest in the case was prompted primarily by its bearing on questions of the general responsibility of the auditor.

4.1 Secret reserves

The Royal Mail case did cause at least some immediate changes in Dutch financial reporting. One Dutch auditor commented in 1932 on his recent observation of

the appearance in a published set of Dutch financial statements of the item ‘By trading account, including secret reserve transfer’, as far as I know a unique occurrence in our financial reporting, and apparently inspired by the verdict regarding the Royal Mail Steam Packet Cy.

(Keuzenkamp, 1932: 30)¹²

It seems, though, that this reaction was the exception rather than the rule and that, in general, attitudes towards the formation and use of secret reserves were only marginally affected. To gauge the more typical Dutch perceptions of the Royal Mail case in the early 1930s, a good starting point is the discussion of the case by Ch. Hageman(1932a) published in one of the main professional journals in April 1932.¹³ After a discussion of the case, including a numerical analysis and extensive quotes from the proceedings in court, he arrived at the following assessment of the relevance of the case for the Dutch situation:

Among Dutch auditors, the formation of undisclosed reserves is in general considered as acceptable and in many instances unavoidable. . . . The essential difference of opinion between English auditors and auditors in this country lies, however, in the case that undisclosed reserves are released to profit without any clear indication (as in the case of the R.M.S.P.). In contrast to his English colleague, the Dutch auditor, when he signs the financial statements without qualification, also gives a clean report on the profit and loss account. In the case [of undisclosed releases], therefore, signing without qualification would be indefensible since the profit balance shown does not correspond at all with the true results from operations, and since the auditor would then collaborate, as in the R.M.S.P. case, in invoking a completely incorrect impression of the financial position. According to what appears from the English professional journals, it will after this case be necessary to verify the correctness of the profit and loss account as well, and in so doing adhere to opinions which have existed for a long time in this country.(Hageman, 1932a: 59)

According to Hageman, therefore, the position on secret reserves that was gradually reached in Britain following the Royal Mail case (their use allowed, but no

¹²Keuzenkamp did not identify the company in question, but in the 1931 annual report of *Werkspoor N.V.*, a major engineering firm, the profit and loss account for 1931 did in fact contain precisely this item ('Per exploitatierekening inclusief dotatie stille reserve'). The direction of the 'transfer' was from the reserve to the profit and loss account, in keeping with the context of the Royal Mail case. The item recurred in the 1932 annual report, but by 1933 the secret reserves were apparently exhausted, and a release of open reserves **was** unable to prevent the profit and loss account from going deeply in the red.

¹³Ch. Hageman (1896-1966) had joined the editorial board of the journal *Maandblad voor Accountancy en Bedrijfshuishoudkunde* in October 1931. Until 1948, he would be section editor of the 'News from abroad' section, which typically contained short clippings from foreign journals with some comments. The article mentioned here, however, was a long leading article.

undisclosed release into income) had already gained acceptance in the Netherlands, owing to the superior notions of proper auditing prevalent in the latter country.

As to the first part of that assertion, it would seem that Hageman, who was at the time not in public practice, was a little optimistic. Views in line with the practices of the Royal Mail Company were aired during the late 1920s, although typically not without opposition (Zeff et al., 1992: 61). In 1929, the *éminence grise* of the Dutch auditing profession, J.G.Ch. Volmer, had dismissed as ‘nonsense’ and ‘academic wisdom’ the assertion that the experience of banks and shipping companies since 1921 had shown that openness in the use of secret reserves would have been in the public interest (Volmer, 1929). During a 1929 NIVA study meeting on secret reserves, views had been expressed ranging from wholehearted endorsement to a reluctant acceptance of established practice, and the issue of undisclosed releases had simply not been addressed (van Uden, 1929).

Rather typical seems to have been the position of A. Sternheim, an auditor who published his own journal of financial news and analysis. In 1930 he did not go beyond stating that the attitude of the auditor towards undisclosed releases was ‘a difficult issue’ (Sternheim, 1930). This position was a little clarified when, in an article commenting on the Royal Mail case, he wrote that ‘a release of secret reserves, by which a loss in any year is transformed into a profit, must be disclosed. An interim position seems to be out of the question’ (Sternheim, 1931). Rather than rejecting secret reserves or even undisclosed releases of secret reserves, this position merely objected against undisclosed releases in cases where the apparent trend of profits was reversed. In other frequently used words, secret reserves were disapproved of only when they were ‘abused’. This position was apparently typical for the leading members of the Dutch profession throughout the 1930s, who were reluctant to rule out undisclosed releases altogether, let alone prohibit the formation of secret reserves (see Keuzenkamp, 1939; de Vries, 1985: 169-71). An important corollary of this point of view was that the auditor had to determine whether in specific instances there had been any ‘abuse’ or misleading use of secret reserves. At this point the second part of Hageman’s argument (cited above) applies, that Dutch auditors, adhering to higher general standards of auditing, were better prepared to prevent such abuses than their British counterparts.

To understand this assertion, it is useful to take a step back and to review briefly the relations between British and Dutch auditing during the first decades of the century and to consider in particular differences in the legal environment and related differences in reflection on the nature of auditing.

4.2 Dutch and British auditing 1900-1930

There can be little doubt that Britain was the single most important foreign point of reference for the young Dutch auditing profession. The Dutch Institute, founded in 1895, was consciously modelled after the example of similar bodies in Britain (Limperg, 1903). British textbooks played an important part in professional education. The extent to which aspiring auditors were to acquaint themselves with British practices may be gauged from the questions listed in reports of oral examinations organised by the NIVA in 1904:

Have you studied Pixley? Tell us something from the chapter on “Profits available for dividends”. . . . What are the regulations in England concerning the auditor’s certificate to the balance sheet? . . . How would you go about the audit of a savings bank, especially with regard to deposits? How do our English colleagues do that? . . . Tell us something about English bookkeeping. . . How do the English divide their ledgers? . . . What does Pixley say about the “Internal Check”? (Reiman and Nijst, 1906: 284)

Professional education continued to rely heavily on British materials at least until the 1930s (Camfferman and Zeff, 1994: 136n). The main accounting journals also devoted considerable space to events in Britain. Even though attention was also paid to Germany, France and, increasingly so as the century progressed, to the United States, British accountancy Britain continued to attract the most attention (Camfferman, 1997: 74). By the 1930s, however, an important turning point was being reached. It was increasingly felt that Dutch auditing had matured to such a level that it no longer needed to take the role of student to the British teachers, and that, in fact, it was reaching for even higher levels.

The emergence of this notion was facilitated by the very limited role of the law in Dutch accounting and auditing in comparison with Britain. This created an opportunity to define the role of the auditor on a theoretical basis independent of legal constraints (cf. Flint (1985: 36)). That the opportunity was seized can be credited largely to Theodore Limperg.

In Britain, the involvement of the law in financial reporting and auditing had followed the growth of modern business as successive Companies Acts had attempted to accommodate changes in the functioning of limited liability companies. The audit and publication of balance sheets of public companies had been mandatory since the Companies Acts of 1900 and 1907, respectively. The 1928 Companies Act fur-

ther extended these requirements by specifying particular items to be shown in the balance sheet and by requiring that a profit and loss account be made available to shareholders. Moreover, a body of jurisprudence had come into existence on issues relating to financial reporting and auditing. It may be true that, ‘accountancy writers could regard the judgments as, in the final analysis, of little significance’ (Napier and Noke, 1992: 39), but the fact that the analysis had to be made at all and the real possibility of the scrutiny of the auditor’s work in court were presumably important reasons why British auditors, in their professional training, placed considerable emphasis on the study of law (Napier, 1996: 452).

Even though by subsequent standards the influence of the law in British accounting of the 1920s may not have been extensive, in the Netherlands this influence was even more slight (see Camfferman (1995); Zeff et al. (1992)). Until 1928, the relevant legal requirements were contained in a Commercial Code that was in this respect virtually unchanged since 1838. For limited liability companies, there was no specification of the form in which an annual account had to be rendered to shareholders, no suggestion of general publicity nor any hint of an audit. Yet, during the 1880s and 1890s, it became common at least for listed companies to publish their balance sheets (and also quite frequently their profit and loss accounts), and a flourishing auditing profession came into being. Perhaps surprisingly, from a British perspective, the courts did not provide any guidance during this stage. Although further research in this area would be desirable, it is probably correct to state that hardly any jurisprudence came into existence before the 1920s if not the 1930s that could provide useful guidance concerning the contents of financial statements or the work of the auditor. A main reason was probably that the statutory footholds for civil and criminal actions against auditors or directors with respect to financial statements were so narrowly defined that **successful** recourse to the courts was possible only in cases of blatant fraud or negligence, and not with a case based on technical niceties of **accounting**.¹⁴

When, in 1928, the Commercial Code was finally revised, the new reporting requirements by and large confirmed the well-established minimum practice of listed companies: the Code required publication of a balance sheet and profit and loss

¹⁴See Volmer (1914: 108) on the Criminal Code clause on directors circulating an ‘untrue’ balance sheet: ‘[it] is a blunt weapon; the falsehood must be written all over [the balance sheet] if a conviction is to follow’. According to van Lier (1927) there was, in fact, no legal ground for criminal proceedings against auditors. With regard to civil law, Grosheide (1928) reported that he knew of only one **case** (in 1918) that had resulted in an auditor having to pay damages to his client for negligence in auditing. See also Knol (1936: 331) for a comment on the paucity of civil cases against directors.

account, provided for a minimum of balance sheet disclosure and information about the valuation of assets, and gave the general meeting of shareholders the right to appoint an auditor. Because the law contained no new departures, it did not affect the position of Dutch auditors who had been used to look elsewhere for guidance in the development of their profession. In the earliest literature, this was commonly done by extensive discussions of foreign regulations (van Slooten, 1900; Volmer, 1914) from which a more or less informed choice was made to provide solutions for problems at hand. But it is Limperg's distinct contribution that he took a different road and managed to persuade a significant proportion of Dutch auditors of the correctness of his views.

Limperg's views on auditing (see Camfferman and Zeff, 1994) assumed that standards for the work of the auditor and the extent of his responsibility were not determined by convention or legal precedent, but by economic rationality. Particularly in the absence of a legally defined position, a long-term future for the auditing profession could be secured only when it defined a role for itself that was economically valuable to others. According to Limperg, such a role could not consist in checking the formal correspondence between the ledger and the financial statements. To a rational reader of financial statements, the audit would be valuable only if it assured him of the substantial correctness of the reported figures. To do so, the auditor had to go beyond the ledger, not merely to check the existence of assets at the balance sheet date, but more fundamentally to judge the correctness of the ending balance sheet figures by reconstructing the flows of money and goods in the course of the year from which the balance sheet position was the result.

Limperg's views, the essence of which was published as early as 1905, involved rather more audit work than traditional practices. They also shifted the focus away from the balance sheet audit towards the audit of the financial statements as an integrated whole. These views were very much Limperg's personal contribution to the Dutch auditing profession in which there was little or nothing that presaged the emergence of such views at that time. Because of this novelty, and presumably also because of the implication of more extensive audit work, Limperg's ideas were not accepted without opposition. But apart from mere conservatism, the nature of some of the opposition was a tribute to Limperg's influence. Because of his own theoretical work, and because of his practical contributions to the integration of the study of accountancy and economics at an academic level, the need for a proper theoretical foundation of auditing was quite widely acknowledged in the Dutch profession. Therefore, those who did not accept Limperg's views could accept that

they had to be opposed on a theoretical level and could therefore give him full credit for raising the standard of reflection in the Dutch auditing profession to levels not reached abroad.¹⁵

As indicated by Edwards (1976), the contrast between Limperg's approach and contemporary British opinions on auditing (but also the opposition to Limperg's views in the Netherlands) are illustrated by the proceedings of the 1926 International Congress of Accountants, held in Amsterdam. At that Congress, both Limperg and Sir William Plender (who, as will be recalled, was to be one of the principal witnesses in the Royal Mail case), spoke on the subject of the responsibility of the auditor. Plender's paper was restricted almost entirely to a legal point of view, illustrating how in Britain (in the words of Edwards) 'the accountant became entirely preoccupied with his legal responsibilities which consequently determined the scope and extent of the audit'. Limperg, in contrast, left juridical concerns expressly out of his speech and attempted to base a theory of auditor responsibility on the premise of an economically rational audit function. In his own words, the contrast was expressed as:

I am thinking more particularly about England, where, it seems to me, the ideas of the accountants about the problem discussed here, are not so much governed by rules derived from the exigencies of the profession as by judicial verdicts and the interpretation of the regulations laid down in the Companies Acts. (Limperg, 1926a: 85)

To Limperg, one of the most important practical consequences was that British auditors took a much too restricted view of their responsibility regarding the profit and loss account. Legally, British auditors had to report on the balance sheet only (a situation that was unaffected by the Companies Act 1928). Limperg strongly believed that British auditors typically restricted their audit to a verification of balance sheet positions, and saw the danger that in such a situation a release of secret reserves into income might be considered as outside the scope of the auditor's responsibility. This contrasted evidently with his own views and to some extent with Dutch practice in which, well before this was required by the Commercial Code reform of 1928 or even the literal sense of the Dutch Institute's own Rules of Professional Conduct, many auditors had accustomed themselves to auditing the

¹⁵E.g. Belle (1931: 5). See Flint (1985) and Munnik (1938: 214) for a retrospective and contemporary international comparison. See Napier (1996) for the absence of academic influence on accounting and auditing in Britain.

balance sheet and the profit and loss account as a single document.¹⁶

At the 1926 Congress, Limperg's views did not come out to advantage. In his presentation, Plender put forward a rather more balanced image of British auditing than the legalistic picture sketched by Limperg. Not only did Plender claim important moral responsibilities for the British auditor, he also strongly took issue with the suggestion that British auditors were negligent with regard to the profit and loss account:

The attachment of the auditor's report only to the Balance sheet did not mean that he had not examined the Profit- and Loss-account. The Balance sheet included the amount to the debit or credit of the Profit and Loss account, and the balance of that account [sic] needed and received just as close a verification as did any other figure on the Balance sheet. So important was this that if it showed a credit balance in excess of what the profit really was and a dividend was improperly [original emphasis] declared and paid out of that balance, the liquidator of the Company, should its circumstances lead to liquidation, might bring an action for breach of duty against directors and auditors. . . . This was elemental to many present, and he only referred to it because some of their brethren from other countries might not quite have understood why the statutory report was fixed only to the Balance sheet of a limited liability company. (Plender, 1926: 109)

This rather clearly put Limperg in his place, and the audience did not hesitate to take a position. One of the Dutch debaters expressed his satisfaction that Plender's speech had confirmed his expectations that 'the interest of their English colleagues extended farther than the final figure of the profits appearing on the balance sheet' (p. 124). Another declared himself in sympathy with the British point of view as opposed to the 'extreme standpoint' taken by Limperg. When the discussion was reviewed in a 1929 Dutch textbook on auditing, the following conclusions were reached regarding to what was styled as the 'Plender-Limperg controversy':

lo. Currently held views [in the Netherlands] on the duty of the auditor of a limited liability company are generally more in conformity with the

¹⁶It may be noted that the perceived difference was purely a matter of auditing principles, not one of financial reporting. Although Limperg was adamant that the profit and loss account be audited, he did not differ from his contemporaries in accepting the often highly condensed format of published profit and loss accounts. Grouping of amounts in single items was considered acceptable as long as the captions correctly indicated the mixed composition of such items. See Hogeweg (1926); Limperg (1926:13).

formulation of this duty in the paper of Plender than with the point of view of professor Limperg.

20. During the last decade, however, an evolution has been discernible in our country in the direction of a higher conception of the auditor's duty. (Nijst, 1929: 120)

4.3 Nature of response to the Royal Mail case

On the previous elements we can build an assessment of the nature of the first set of reactions to the Royal Mail case. As seen above, the case did not cause a break in the practice of secret reserve accounting. The existence of secret reserves, though questioned, remained a part of accepted practice.¹⁷ At best, the case somewhat refined discussions on secret reserve accounting as it brought to the fore the issue of undisclosed releases which, prior to 1929, was not a regular element of such discussions.

The importance of the case in this period lies therefore not in its direct implications for secret reserve accounting, but in its implications for the more general process of reflection on the nature and course of the auditing profession. The case provided a vivid illustration of a number of propositions that Limperg and his followers had for a considerable time but with as yet incomplete success urged Dutch auditors to accept. These included the inadequacy of reliance on precedent in general and the acceptance of British auditing practice as normative in particular, the dangers of a strict legalism and, positively, the necessity of auditing the balance sheet and the profit and loss account as an integrated whole.

We do not know about Limperg's private reaction to the case. However, one cannot help but wonder about his feelings when he learned that his former opponent, Plender, was forced to argue that his confident words at the 1926 Congress about the obvious legal responsibility of the auditor for disclosure of releases from secret reserves, did not apply to the case in which he appeared as a *de facto* witness for the defence.¹⁸ But, thanks to the Royal Mail case, the argument that British auditors

¹⁷Not in the least because in the preparation of the Commercial Code revision the Justice Ministry had explicitly indicated that it did not object to undisclosed reserves provided that their existence could be inferred from a careful reading of the financial statements. See also van der Heijden (1929: 359).

¹⁸If Dutch contemporaries did at all link Plender's appearance in the Royal Mail trial with his utterances at the 1926 Congress, this did not affect his subsequent stature in the Netherlands. Plender had quite a reputation among Dutch auditors and with his peerage (conferred in 1931) and his country estate was a perfect symbol of the difference in social standing between British and Dutch auditors, of which the latter were keenly aware (Anonymous, 1933; van Dien, 1930). In a 1933 discussion meeting, someone suggested that a Dutch auditor in charge of the audit of a holding company could not conceivably be so insolent as to send a working programme for the

had a legalistic and restricted view of their responsibilities resurfaced in the Dutch literature. It may be recalled that Hageman, quoted at length at the start of this section, pointed to this issue in explaining the significance of the Royal Mail case. Another auditor who considered himself part of Limperg's school, van Rietschoten, commented negatively on the legal advice received and published by the Council of the English Institute on the implications of the Royal Mail case. First, the legal counsel was cited as follows:

In our opinion, having regard to the fact that the balance sheet contains as one of its items the balance brought in from the profit and loss account, [the auditors] *cannot dissociate themselves from all responsibility* [emphasis added by van Rietschoten] for the correctness of that account and there may be cases in which it would be incumbent upon them to draw the attention of shareholders to any feature of that account which in their view involved anything of an improper or misleading character.¹⁹

This elicited the following comment by van Rietschoten:

This statement once again clearly demonstrates the necessity that the English auditor's opinion no longer be confined to the balance sheet, but is also extended to the profit and loss account. The reasoning quoted here is really so useless that probably no-one will have read it with satisfaction. (van Rietschoten, 1932)²⁰

Following the Royal Mail case, Limperg himself also confidently repeated his perception of British auditing, even though this had been declared invalid at the 1926 Congress. When British professional journals commented unfavourably on the wording of the (Dutch) auditor's report on the annual reports of the Philips company, Limperg retorted:

It is known to all serious students, and it has repeatedly become publicly known, that the English auditor generally restricts his task far more [than the Dutch auditor]; and that he often restricts it too much by certifying only the balance sheet and not the profit and loss account,

audit of a subsidiary to 'Lord Plender of Price, Waterhouse & Co'. Another argued that this was quite possible, provided that the British auditor was treated with due respect (at the meeting, no one observed that Plender was mentioned in connection with the wrong firm) (see Polak, 1933).

¹⁹Van Rietschoten cited the counsel's opinion in Dutch. The text cited here is the original English in "The Institute of Chartered Accountants and the Royal Mail Case — Counsel's opinion", *The Accountant* vol. 85 no. 2976, 19 December 1931, p. 804-805, with Van Rietschoten's italics added.

²⁰Van Rietschoten's reaction may have been coloured by his apparent belief that he was citing the Institute's Council rather than the opinion of counsel.

and by relying in numerous parts of the audit on the opinion of the auditee and his employees (Limperg, 1935).

Seen in this way, the Royal Mail case provided Limperg and his adherents with support in what was, in effect, an ongoing battle over standards of auditing in the Netherlands. But the Royal Mail case did not start this battle, nor is there any reason to attribute it an inordinately heavy weight in settling the issue in Limperg's favour. But that it was settled in his favour shortly afterwards is beyond doubt. According to a recent history of the NIVA, 'in the years between 1935 and 1946, the last resistance within the NIVA against Limperg's approach was broken.' Among other things, this meant that the NIVA's code of conduct henceforth formally prohibited the audit of two successive balance sheets without an audit of the profit and loss account over the intervening period (see de Vries, 1985: 171). This feature could be cited to show how auditing in the Netherlands had reached a higher plane than in Britain (see Limperg (1965: 129) and Tempelaar (1952:13)). In general, the process of emancipation from British leadership was completed, following which 'in large sections of the Institute the opinion prevailed that no one could match the Dutch profession with its theoretical foundation according to Limperg' (de Hen et al., 1995: 18).

5 Subsequent reactions 1946-1950

As related in section 2, the effects of the Royal Mail case in Britain had not worked themselves out by the mid-1930s but continued to be felt until well into the 1940s. Although initial British reactions to the case may have been 'ineffective and muddled' (Napier, 1995), by the time of the Companies Act 1947 there was no mistaking the extent of the changes that had been brought about. In the Netherlands, the preparations leading up to the Companies Act, and the provisions of the Act themselves, were a sufficient stimulus to recall the Royal Mail case, and to question whether the reaction of the Dutch auditing profession to that event was still adequate. At this stage, the focus of attention shifted away from the issue of the auditor's responsibility towards the acceptability of secret reserve accounting.

This distinction between the auditing and financial reporting aspects of the Royal Mail case helps to understand the different evaluation of events in Britain which forms a recurring theme in the post-war Dutch literature. Those who focused on auditing issues would see the Cohen Committee's report and the Companies Act 1947 as attempts to catch up with the more advanced Dutch standards. Those who

focused on reporting standards, and in particular on secret reserves, would see the same events as signs of a new departure in which the Netherlands risked falling behind.

The comfortable pre-war position that the lessons of the Royal Mail case were primarily applicable to Britain itself is represented by the auditors Porrey (1950) and Stokvis (1950), who linked the Companies Act with the implications of the Royal Mail case in terms of the auditor's responsibility for the profit and loss account. Both concluded that, as a result of the lessons drawn from the case and their codification in the Companies Act, British auditing standards had much improved. Stokvis argued, however, on the basis of a review of the British literature since the Royal Mail case, that there was still room for further improvement. He believed that, since the London Congress of 1933, British auditors were less inclined to define their responsibility in purely legal terms, and that there was a growing attention for the audit of the profit and loss account. Yet, he concluded, 'these important events [the Companies Act 1929 and the Royal Mail case] have not, in my opinion, had the result that in England the importance and the audit of the profit and loss account are seen in the same way as in this country' (p. 17).

The alarmist position, on the other hand, was taken by G.K.H. Hinnen. He was originally not a NIVA member, but had joined when two smaller organisations of auditors merged with the NIVA in 1935. As a representative of his organisation, he had attended the 1933 London Congress himself, including the presentation of Henri Morgan's paper, fraught with references to the Royal Mail case. In the discussion of that paper, Hinnen had clearly stated his beliefs that 'a balance sheet that contains secret reserves does not show a true and correct view of the state of the company's affairs' (Morgan, 1933: 579).

Following the merger of 1935, Hinnen became a member of the key NIVA committee charged with revising the NIVA's Rules of Professional Conduct. It may be noted that this revision was an important part in the movement to enshrine Limperg's views on auditing as the dominant outlook of the Dutch auditing profession. Limperg, who was chairman of the committee, also saw the work of the committee as a further move ahead of the British example.²¹

In the course of their activities, the committee members came across the issue of secret reserves and, from the moment the issue was raised, Hinnen consistently

²¹During one of the committee's first meetings, Limperg argued that the absence of similar Rules of Professional Conduct in Britain 'has as a consequence that developments there have come to a halt. Over there, appeals to jurisprudence are made and it is so much more difficult to change that.' (Minutes of meeting 4 July 1931, p. 4)

put forward his opinion that both the existence and the release of secret reserves into income had at least to be indicated in the financial statements. On this issue he found all the other members against him, who argued that the abuse rather than the use of secret reserves had to be halted, and that the auditor's responsibility as defined in the new Rules was the proper safeguard.²² In its final report, published in 1939, the committee stated that they were aware of the dangers attached to secret reserves, but that they considered a prohibition to be 'too great a hindrance to sound business life'. Revealing the existence of secret reserves was not, in their opinion, a prerequisite for obtaining an unqualified report. Yet, the committee was obliged to report Hinnen's opposition as a minority view (NIVA, 1946: 54). After the interruption of the Second World War, discussions on the committee's report continued and in 1946, Hinnen repeated his objections to secret reserves in a strongly worded speech at a membership meeting. He deplored the lack of critical views on secret reserves in the Dutch literature, and he referred his audience to Morgan's 1933 paper and its discussion of the Royal Mail case. He presented the Cohen Committee's report as a recent consequence of the case and observed that 'while in England measures will probably be taken against secret reserves, we will be setting our clocks backward.' He warned: 'I am convinced that in this way we will presently have our own Royal Mail affair' (NIVA, 1946: 66-7). Limperg expressed his sympathy with Hinnen's intentions, but made it clear that for the time being it was not up to the auditor to prevent *bona fide* companies from forming secret reserves. As to the reference to England, Limperg observed:

Even though England has been shaken by the serious case of the Royal Mail, in which secret reserves were used to pay dividends in years of adversity, we must not let ourselves be intimidated by that case. We are further ahead in our convictions regarding the conscientious practice of our profession than in England. If such a case should occur, the Dutch auditor would certainly not, according to these proposed Rules, be exonerated. (NIVA, 1946: 93)

In the end, Hinnen's objections to the new Rules' treatment of secret reserves did not prevail. Hinnen, however, pledged to 'personally continue the battle against secret reserves', which he did with a subsequent publication (Hinnen, 1948a) in which he argued that the tide of history, as far as secret reserves were concerned, was moving from the Royal Mail case to the Cohen Committee's report and the

²²Minutes of 21 March 1936, 11 July 1936, 23 April 1938 and 9 July 1938.

Companies Act, and that the Dutch profession would do well to adjust itself to it.

Support for Hinnen's assertion that the Royal Mail case held lessons for the Dutch with regard to secret reserve accounting came from J.E. Spinosa Cattela, a former internal auditor of Philips who had, by living and working abroad for a number of years, obtained first-hand experience of financial reporting practices in a number of English-speaking countries. In 1948, he published an introductory auditing text book for the Dutch market which devoted no fewer than six pages to the Royal Mail case in its discussion of secret reserves. Included in this section were several long quotations from Mr. Justice Wright's famous address to the jury (Spinosa Cattela, 1948: 113-8). From this and many other references to the British and American literature, it is evident that the author, who also acknowledged the value of the specifically Dutch contributions to auditing made by Limperg and others, wanted to impress his readers with the relevance of foreign contributions in the area of financial reporting.

A somewhat similar judgement came from Ch. Hageman. While in his 1932 review (see above), he had concluded that the lessons from the Royal Mail case were already discounted in Dutch practice, he wrote in 1946 on the Cohen Committee's proposals regarding secret reserves, and gave his impression that 'a new direction is taken in the publication of English annual reports' (Hageman, 1946: 254). The next year he reviewed an article on 'accounting principles' in *The Accountant* and commented

The battle on secret reserves came into an interim phase because of the Royal Mail Case. Lord Plender then gave his opinion that the release of secret reserves had to be disclosed. . . now we have come to the principle that both the creation and the use of secret reserves must be made public . . . On reading the above, the thought suggests itself that the backwardness of 'accounting principles' in Great Britain has largely disappeared and changed itself into a lead regarding the publication of financial statements, especially with respect to secret reserves. (Hageman, 1947: 97-8)

In addition, other positive assessments of the Cohen Committee's report and the Companies Act 1947 (e.g. ten Bosch, 1948; Valkhoff, 1946) showed that innovations in British financial reporting regulation were seen as highly significant.

Of course, there were more critical voices as well. Hinnen's (1948a) article provoked a public discussion with R.A. Dijker, a senior member of the Dutch profession

(but not a **Limperg** adherent by any standard). Dijker argued that the Royal Mail case represented just a more extreme form of abuse that could not be used to argue against the use of secret reserves in general (Dijker, 1948a). Similarly, it was observed in a review of Spinosa Cattela's textbook that 'the foreign jurisprudence reported in later chapters might, in my opinion, have been discussed less extensively (for example the Royal Mail case)' (Hogeweg, 1948: 350). ²³ The extensive discussion of the Royal Mail case was retained in the second (1952) edition of the textbook, however.

What we can conclude from this brief review is that in the post-war years, the Royal Mail case, reinforced by the Companies Act 1947, made a reappearance in the consciousness of Dutch auditors, this time in connection with the issue of secret reserve accounting for which it is best known. The relevance of the case to Dutch circumstances was, however, disputed. The most dire prediction, that the Netherlands would soon have its own Royal Mail case, was not vindicated, and perhaps partly for that reason, the issue of secret reserve accounting would not be settled definitively until the introduction of new legal reporting regulation in 1970.

While secret reserves continued to exercise the minds of auditors, the post-1950 literature on the issue would, with few exceptions (Foppe, 1955; Tempelaar, 1952a) no longer refer to the Royal Mail case. The most obvious reason for this is that by the early 1950s, the case had become an occurrence of some twenty years past, and that new, domestic points of reference had become available. ²⁴

6 Concluding remarks

By documenting Dutch reactions to the Royal Mail case, this paper has shown that this landmark event in the history of British accountancy did not go unnoticed in the Netherlands. Moreover, the nature of the reactions to the case allows some inferences to be drawn regarding the connections between the history of financial reporting and auditing in the two countries.

²³See also the critical review by Dijker, who criticised the author for being too much under the influence of 'the older English literature' (Dijker, 1948b).

²⁴This can be seen in the preparations of a NIVA discussion memorandum on secret reserve accounting and the role of the auditor. The committee charged with preparing the memorandum **was** installed in 1953. In the initial discussions, **favourable** references to Britain, in particular the Companies Act, were quite prominent (The Royal Mail case **made** but one fleeting appearance in the committee's files). After 1955, a set of recommendations on financial reporting issued by the Dutch employer's associations (Zeff et al., 1992: 94-114) became the main point of reference and in the final committee report (NIVA, 1962), no references to Britain or indeed any foreign country were included. See files of the Bos Subcommittee (NIVA-archives file 776), in particular nos 26, 123, 205-206, 235-236).

The case illustrates that Dutch auditors were reasonably aware of British affairs. Moreover, they were capable of interpreting these events correctly in the sense that the case was cited in connection with the same main issues that the case had raised in Britain: secret reserves and the nature and extent of the auditor's responsibility.

Moreover, it has been shown that a number of individuals throughout the period were quite active in consciously positioning Dutch accountancy relative to its counterpart in Britain. They could differ in their assessments as to whether the Netherlands was ahead or behind Britain, but by agreeing on Britain as a relevant benchmark they ensured that Dutch accountancy did not develop in isolation.

With regard to the Royal Mail case itself, it has been shown how its direct effect in the Netherlands was fairly small. Apart from the fact that even in Britain a common perception of the Royal Mail case emerged only after a number of years, this was caused by the impression of a substantial group of Dutch auditors, led by Limperg, that the case was not a signal that change was required in the Netherlands. Rather, the case confirmed their views on a number of issues regarding auditor responsibility, such as the imperative of considering extra-legal responsibilities and the necessity of auditing the profit and loss account. On these issues, it was believed, the Netherlands was ahead of Britain. It is beyond the scope of this paper to determine to what extent this belief was shared and reflected in practice. At the time, there was certainly considerable opposition to Limperg's views and it would be rash to conclude that practices like those of the Royal Mail Company did not occur in the Netherlands simply because Limperg insisted that the auditor should take responsibility for the correctness of the income statement.

Indirectly, through the Companies Act 1947, the Royal Mail case exerted some influence on Dutch accounting. The provisions of the Act brought the issue of secret reserves to the attention of Dutch auditors and reawakened memories of the case. But by that time, the notion of the superiority of Dutch auditing standards (to which the Royal Mail case had arguably contributed) was so well established that the auditing profession proceeded to solve that issue in the following years on the basis of purely domestic arguments.

The limitations of this paper, its simplifying focus on a single event and its almost exclusive reliance on utterances by the limited group of Dutch auditors whose opinions were recorded in print, are apparent. Further research, based on a direct comparison of actual reporting practices or focusing on the contents of professional education is therefore appropriate if we want to increase our understanding of how, even without conscious British effort, knowledge of British accounting and auditing

helped to shape continental European practices and standards.

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